

**CITY OF TORRANCE
WATER FUND**

(An Enterprise Fund of the
City of Torrance, California)

Basic Financial Statements

Year ended June 30, 2012

(With Independent
Auditors' Report Thereon)

CITY OF TORRANCE WATER FUND

(An Enterprise Fund of the City of Torrance, California)

Basic Financial Statements

Year ended June 30, 2012

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The Honorable City Council
City of Torrance, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statement of net assets of the City of Torrance Water Fund (an Enterprise Fund of the City of Torrance, California), as of June 30, 2012, and the related statement of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the City of Torrance's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the financial statements of the City of Torrance Water Fund for the year ended June 30, 2011 and, in our report dated December 9, 2011, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial statements present only the City of Torrance Water Fund and are not intended to present the financial position of the City of Torrance, California, and the results of its operations and the cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Torrance Water Fund as of June 30, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Mayer Hoffman McCann P.C.

Irvine, California
December 21, 2012

CITY OF TORRANCE
WATER FUND
(An Enterprise Fund of the City of Torrance, California)
Statement of Net Assets
June 30, 2012
(with comparative totals for the prior year)

Assets		
	2012	2011
Current assets:		
Pooled cash and investments (Note 2)	\$ 7,182,600	\$ 4,626,179
Cash and investments with fiscal agents (Note 2)	527,100	554,333
Accounts receivable	6,486,311	5,603,933
Accrued interest receivable	33,521	16,797
Inventory	484,885	475,725
Prepays	-	95
Total current assets	<u>14,714,417</u>	<u>11,277,062</u>
Noncurrent assets:		
Advance to Successor Agency (Note 4)	1,154,432	1,154,432
Capital assets, net (Note 5)	<u>67,003,136</u>	<u>66,736,447</u>
Total noncurrent assets	<u>68,157,568</u>	<u>67,890,879</u>
Total assets	<u>82,871,985</u>	<u>79,167,941</u>
Liabilities		
Current liabilities:		
Accounts payable	4,642,025	3,916,684
Contract retainage payable	106,885	52,483
Accrued liabilities	1,007,637	347,455
Construction advances	26,570	14,570
Current bonds payable - interest	17,767	26,766
Current bonds payable - principal (Note 6)	<u>570,000</u>	<u>540,000</u>
Total current liabilities	<u>6,370,884</u>	<u>4,897,958</u>
Noncurrent liabilities:		
Long-term obligations (Note 6)	<u>620,000</u>	<u>1,190,000</u>
Total noncurrent liabilities	<u>620,000</u>	<u>1,190,000</u>
Total liabilities	<u>6,990,884</u>	<u>6,087,958</u>
Net Assets		
Invested in capital assets, net of related debt	66,340,236	65,560,780
Unrestricted	<u>9,540,865</u>	<u>7,519,203</u>
Total net assets	<u>\$ 75,881,101</u>	<u>\$ 73,079,983</u>

See accompanying notes to the basic financial statements

CITY OF TORRANCE
WATER FUND
(An Enterprise Fund of the City of Torrance, California)
Statement of Revenues, Expenses and Changes in Net Assets
Year ended June 30, 2012
(with comparative totals for the prior year)

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Charges for services	\$ 32,538,639	\$ 29,037,031
Other	<u>1,472,196</u>	<u>1,122,133</u>
Total operating revenues	<u>34,010,835</u>	<u>30,159,164</u>
Operating expenses:		
Salaries and employee benefits	4,770,869	4,551,033
Services and supplies	1,440,966	1,512,186
Other professional services	855,324	718,648
Depreciation and amortization	1,311,086	1,355,003
Insurance and claims	127,970	78,735
City charges	1,722,776	1,904,272
Cost of water	20,591,517	18,671,109
Other	<u>460,844</u>	<u>442,353</u>
Total operating expenses	<u>31,281,352</u>	<u>29,233,339</u>
Operating income	<u>2,729,483</u>	<u>925,825</u>
Nonoperating revenues (expenses):		
Investment earnings	146,001	100,880
Interest expense	<u>(74,003)</u>	<u>(100,244)</u>
Total nonoperating revenues, net	<u>71,998</u>	<u>636</u>
Income before contributions and operating transfers	2,801,481	926,461
Capital grants	21,679	35,227
Transfers to the City of Torrance	<u>(22,042)</u>	<u>(30,398)</u>
Change in net assets	2,801,118	931,290
Net assets - beginning	<u>73,079,983</u>	72,148,693
Net assets - ending	<u><u>\$ 75,881,101</u></u>	<u><u>\$ 73,079,983</u></u>

See accompanying notes to the basic financial statements

CITY OF TORRANCE**WATER FUND**

(An Enterprise Fund of the City of Torrance, California)

Statement of Cash Flows

Year ended June 30, 2012

(with comparative totals for the prior year)

	2012	2011
Cash flows from operating activities:		
Receipts from customers	\$ 31,656,261	\$ 27,767,145
Cash payments to suppliers for goods and services	(24,994,465)	(23,235,398)
Cash payments to employees for services	(4,739,286)	(4,491,155)
Other receipts	1,472,196	1,122,133
Net cash provided by operating activities	<u>3,394,706</u>	<u>1,162,725</u>
Cash flows from noncapital financing activities:		
Cash paid to the City of Torrance	(22,042)	(30,398)
Net cash used in noncapital financing activities	<u>(22,042)</u>	<u>(30,398)</u>
Cash flows from capital financing activities:		
Cash received from grants and subsidies	21,679	35,227
Cash payments for capital additions	(371,430)	(654,698)
Cash payments for long-term bonds - principal & interest	(623,002)	(623,828)
Net cash used in capital financing activities	<u>(972,753)</u>	<u>(1,243,299)</u>
Cash flows from investing activities:		
Cash received from interest on investments	129,277	127,077
Net increase in cash, restricted cash and cash equivalents	2,529,188	16,105
Cash, restricted cash and cash equivalents, July 1	<u>5,180,512</u>	<u>5,164,407</u>
Cash, restricted cash and cash equivalents, June 30	<u>\$ 7,709,700</u>	<u>\$ 5,180,512</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 2,729,483	\$ 925,825
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	1,311,086	1,355,003
Change in assets and liabilities:		
Accounts receivable	(882,378)	(1,269,886)
Inventory	(9,160)	(58,196)
Prepays	95	1,457
Accounts payable	201,997	151,583
Accrued salaries and benefits	31,583	59,879
Construction advances	12,000	(2,940)
Net cash provided by operating activities	<u>\$ 3,394,706</u>	<u>\$ 1,162,725</u>

Noncash investing, capital and financing activities:

There were no significant noncash investing, capital or financing activities for the year ended June 30, 2012.

See accompanying notes to the basic financial statements

CITY OF TORRANCE WATER FUND
(An Enterprise Fund of the City of Torrance, California)

Notes to the Basic Financial Statements

Year Ended June 30, 2012

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The City of Torrance Water Fund (Water Fund) is an Enterprise Fund of the City of Torrance, California (the City), created in 1952 by an ordinance of the City Council. In 1960, Municipal Water Districts 1, 2, and 3 were absorbed by the Water Fund.

Water Fund operations provide water service to approximately 75% of the geographic area of the City. These operations constitute part of the overall financial reporting entity of the City and have been included in and accounted for as an Enterprise Fund in the City's Comprehensive Annual Financial Report in accordance with generally accepted accounting principles.

(b) Basis of Accounting

The Water Fund is reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flow. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, for Proprietary Fund accounting, the City applies all applicable GASB pronouncements, as well as the pronouncements of the Financial Accounting Standards Board (FASB) and its predecessor authoritative Boards, issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses result from providing services in connection with the Water Fund's principal ongoing operations. The principal operating revenues of the Water Fund are through charges of water service. Operating expenses for the Water Fund include the cost of water, operations of the facilities, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(c) Property, Plant, and Equipment

Property, plant, and equipment are recorded at historical cost, except for assets acquired prior to June 30, 1980, which are recorded at estimated historical cost based, to the maximum extent possible, on historical cost records. City policy has set the capitalization threshold for reporting capital assets at \$5,000. In accordance with generally accepted accounting principles, it is the Water Fund's policy to capitalize net interest costs on funds borrowed to finance the construction of certain fixed assets. Capitalized interest is amortized over the estimated useful life of such assets. Depreciation is determined using the straight-line method, with no allowance for salvage values. Depreciation on assets acquired with contributed capital is charged to operations and then transferred to the related contributed capital account.

CITY OF TORRANCE WATER FUND
(An Enterprise Fund of the City of Torrance, California)

Notes to the Basic Financial Statements

Year Ended June 30, 2012

The estimated useful lives used in computing depreciation of property, plant, and equipment are as follows:

Reservoirs, wells and supply mains	50 to 75 years
Transmission and distribution system	75 years
Machinery and equipment	5 to 20 years

(d) Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include unrestricted and restricted cash on hand and investments purchased with a maturity within 90 days.

(e) Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(f) Comparative data

The Water Fund Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows shows data for the fiscal year ended June 30, 2011 for comparative purposes only.

(2) Pooled Cash and Investments

Cash and investments at June 30, 2012 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Pooled cash and investments	\$7,182,600
Cash and investments with fiscal agents	<u>527,100</u>
Total cash and investments	<u>\$7,709,700</u>

Cash and investments at June 30, 2012 consist of the following:

Equity in City investment pool	\$7,182,600
Investments	<u>527,100</u>
Total cash and investments	<u>\$7,709,700</u>

CITY OF TORRANCE WATER FUND
(An Enterprise Fund of the City of Torrance, California)

Notes to the Basic Financial Statements

Year Ended June 30, 2012

Equity in the Cash and Investment Pool of the City of Torrance

The Water Fund (Fund) has no separate bank accounts or investments other than investments held by bond trustee and the Fund's equity in the cash and investment pool managed by the City of Torrance. The Fund is a voluntary participant in that pool. This pool is governed by and under the regulatory oversight of the Investment Policy adopted by the City Council of the City of Torrance. The Fund has not adopted an investment policy separate from that of the City of Torrance. The fair value of the Fund's investment in this pool is reported in the accompanying financial statements at amounts based upon the Fund's pro-rata share of the fair value calculated by the City for the entire City portfolio. The balance available for withdrawal is based on the accounting records maintained by the City, which are recorded on an original cost basis.

Investments Authorized by the California Government Code and the City of Torrance Investment Policy

The table below identifies the **investment types** that are authorized for the City of Torrance by the California Government Code and the City of Torrance investment policy. The table also identifies certain provisions of the California Government Code (or the City of Torrance investment policy, if more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City of Torrance, rather than the general provisions of the California Government Code or the City of Torrance investment policy.

Investment Types <u>Authorized by State Law</u>	Authorized By Investment <u>Policy</u>	*Maximum <u>Maturity</u>	*Maximum Percentage <u>Of Portfolio</u>	*Maximum Investment <u>In One Issuer</u>
Local Agency Bonds	Yes	5 years	10%	None
U.S. Treasury Obligations	Yes	5 years	None	None
U.S. Agency Securities	Yes	5 years	75%	30%
Banker's Acceptances	Yes	180 days	20%	5%
Commercial Paper	Yes	270 days	15%	10%
Negotiable Certificates of Deposit	Yes	5 years	20%	None
Repurchase Agreements	Yes	30 days	10%	None
Reverse Repurchase Agreements	No	N/A	N/A	None
Medium-Term Notes	Yes	5 years	20%	None
Mutual Funds	No	N/A	N/A	N/A
Money Market Mutual Funds	No	N/A	None	None
Mortgage Pass-Through Securities	No	N/A	N/A	None
County Pooled Investment Funds	No	N/A	N/A	None
Local Agency Investment Fund (LAIF)	Yes	N/A	\$50 mil per agency	None
JPA Pools (other investment pools)	No	N/A	N/A	None

* Based on state law requirements or investment policy requirements, whichever is more restrictive.

CITY OF TORRANCE WATER FUND
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Notes to the Basic Financial Statements

Year Ended June 30, 2012

Investments Authorized by Debt Agreements

Investments of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Fund's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk** and **concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None
Local Agency Invest Fund	None	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the Fund's exposure to interest rate risk as a result of its equity in the cash and investment pool of the City is provided by disclosures in the notes to the basic financial statements of the City that shows the distribution of the City's investment by maturity.

CITY OF TORRANCE WATER FUND
(An Enterprise Fund of the City of Torrance, California)

Notes to the Basic Financial Statements

Year Ended June 30, 2012

Information about the sensitivity of the fair values of the City investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the City investments, related to the Fund's bond debt, by maturity:

<u>Investment Type</u>		<u>Remaining Maturity (in Months)</u>			
		<u>12 Months Or Less</u>	<u>13 to 24 Months</u>	<u>25 to 60 Months</u>	<u>More Than 60 Months</u>
Held by bond trustee:					
Investment contracts	\$ 527,100	-	527,100	-	-
	<u>\$ 527,100</u>	<u>-</u>	<u>527,100</u>	<u>-</u>	<u>-</u>

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Fund's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>AA</u>	<u>Not Rated</u>
Held by bond trustee:						
Investment contracts	\$ 527,100	N/A	-	-	-	527,100
	<u>\$ 527,100</u>		<u>-</u>	<u>-</u>	<u>-</u>	<u>527,100</u>

CITY OF TORRANCE WATER FUND
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Notes to the Basic Financial Statements

Year Ended June 30, 2012

Concentration of Credit Risk

Investments held by bond trustee in the amount of \$527,100 are in the form of a nonnegotiable unrated investment contract issued by the FSA Capital Management that matures on February 28, 2014.

Custodial Credit Risk

The Fund does not have significant separate certificates of deposit or demand accounts held by bond trustee that are subject to disclosable custodial credit risk (as defined by GASB Statement No. 40). The Fund does not have direct investments in securities subject to disclosable custodial credit risk (as defined by GASB Statement No. 40).

For the investments held by bond trustee, the bond trustee, at the direction of the City Treasurer, selects the investment under the terms of the applicable trust agreement, acquires the investment, and holds the investment on behalf of the reporting government.

(3) Transactions with Related Parties

The City allocates certain administrative and overhead costs to the Water Fund based on a formal indirect cost allocation plan. The charges are based upon a fixed rate applied to direct salaries and wages of the Water Fund and amounted to \$917,856 and \$856,194 for the years ended June 30, 2012 and 2011, respectively.

In addition, the City charged the Water Fund \$718,000 in lieu of property taxes for the years ended June 30, 2012 and 2011. (See notes 6, 7 and 8 for additional transactions with the City.)

(4) Advance to the Successor Agency

The advance in the amount of \$1,154,432 represents a loan to the Successor Agency Trust for assets of the former redevelopment agency to fund infrastructure improvements. All redevelopment agencies in the State of California were dissolved effective February 1, 2012.

CITY OF TORRANCE WATER FUND
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Notes to the Basic Financial Statements

Year Ended June 30, 2012

(5) Capital Assets

For the year ended June 30, 2012, capital assets consisted of the following:

Land	\$ 3,448,880	-	-	3,448,880
Construction in progress	5,375,874	1,466,803	-	6,842,677
Total nondepreciable assets	<u>8,824,754</u>	<u>1,466,803</u>	<u>-</u>	<u>10,291,557</u>
Depreciable assets:				
Infrastructure	90,720,467	110,972	-	90,831,439
Machinery and equipment	1,142,288	-	-	1,142,288
Total depreciable assets	<u>91,862,755</u>	<u>110,972</u>	<u>-</u>	<u>91,973,727</u>
Accumulated depreciation:				
Infrastructure	(32,854,884)	(1,294,512)	-	(34,149,396)
Machinery and equipment	<u>(1,096,178)</u>	<u>(16,574)</u>	<u>-</u>	<u>(1,112,752)</u>
Total accumulated depreciation	<u>(33,951,062)</u>	<u>(1,311,086)</u>	<u>-</u>	<u>(35,262,148)</u>
Total capital assets being depreciated, net	<u>57,911,693</u>	<u>(1,200,114)</u>	<u>-</u>	<u>56,711,579</u>
Total capital assets, net	<u>\$ 66,736,447</u>	<u>266,689</u>	<u>-</u>	<u>67,003,136</u>

(6) Refunding Bonds

In December 2004, the City of Torrance issued \$5,050,000 in Water Revenue Refunding Bonds, Series A (2004 debt), to provide funds for the redemption of its \$8,065,000 1994 Water Revenue Refunding Bonds and for the construction of various water projects and related facilities for the City's water system. Debt proceeds and 1994 Water Revenue Bond reserves of \$5,296,684 were deposited in an irrecoverable trust with an escrow agent to redeem the 1994 Bonds on December 1, 2004. Accordingly, such bonds, aggregating \$5,090,000, were considered defeased and the liability was removed from the Water Fund on fiscal year ended June 30, 2005. The refunding resulted in a net accounting loss of \$148,186, which was expensed in fiscal year ended June 30, 2005, instead of amortizing over the life of the bonds due to the amount being immaterial.

CITY OF TORRANCE WATER FUND
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Notes to the Basic Financial Statements

Year Ended June 30, 2012

The refunding bonds bear interest rates ranging from 3.0% to 5.0%. Interest is payable semiannually on March 1 and September 1. Among the provisions of the bond resolutions, the Water Fund covenants require that fees and charges for water services must be sufficient to yield net revenues equal to at least 125% of debt service for such fiscal year. At June 30, 2012, the \$1,190,000 face amount of the refunding bonds was outstanding, of which \$570,000 has been classified as a current liability in the accompanying financial statements.

Annual debt service requirements to maturity are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2013	570,000	53,300	623,300
2014	<u>620,000</u>	<u>24,800</u>	<u>644,800</u>
Total	\$ <u>1,190,000</u>	<u>78,100</u>	<u>1,268,100</u>

(7) Employee Benefits

The City has an approved deferred compensation plan under which employees may elect to defer a portion of their annual compensation by direct deposit to the plan. Subject to Internal Revenue Service regulations, such compensation is not subject to income taxes to the employee until withdrawal at time of retirement, termination or on an extended basis at the election of the employee under certain options of the plan.

Federal legislation, approved a number of years ago, requires that Section 457 plan assets be held in trust for employees. As of January 1, 1999, the City implemented this requirement by transferring all Section 457 plan assets to a trustee. As such, Section 457 plan assets are no longer legally the property of the City and are no longer subject to claims of the City's general creditors.

(8) Pension Plan

Full-time Water Fund employees participate with other City employees in the Public Employees' Retirement System (PERS) of the State of California. Contributions are made by both the Water Fund and its employees. The Water Fund's contribution represents a pro rata share of the City's contribution, which is based on the system's determination as of July 1 of the current fiscal year. Total pension expense allocated to the Water Fund by the City for years ended June 30, 2012 and 2011 amounted to \$577,425 and \$497,943, respectively.

PERS does not provide data to participating organizations in such a manner as to facilitate separate disclosure for the Water Fund of the actuarially computed present value of vested and nonvested accumulated plan benefits, the plan's net assets available for benefits, assumed rates of return used or the actuarially computed value of vested benefits over the related pension fund assets. Additional information regarding the City's participation in PERS can be found in the City's Comprehensive Annual Financial Report.

CITY OF TORRANCE WATER FUND
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Notes to the Basic Financial Statements

Year Ended June 30, 2012

(9) Self-Insurance Program

The Water Fund is part of the City's self-insurance program for general and automobile liability claims, as well as for workers' compensation claims. The self-insured retention on general and automobile liability claims is \$5,000,000 per occurrence. There is excess coverage of \$20,000,000 available above the \$5,000,000 self-insured retention. In addition, the self-insured retention on workers' compensation claims is \$2,000,000 per occurrence. There is excess coverage available for claims above \$2,000,000 up to State of California statutory limits. Information concerning the City's self-insurance program can be found in the City's Comprehensive Annual Financial Report for the year ended June 30, 2012.

Insurance and claims expense amounted to \$73,915 and \$77,308 for the years ended June 30, 2012 and 2011, respectively.

(10) Commitments

The Water Fund has various outstanding contracts for services, materials and capital projects that have not been completed as of fiscal year-end. These commitments total approximately \$354,094 at June 30, 2012.

